

Office of Inspector General

Audit of FCA's Financial Statements
Fiscal Year 2007



November 2007

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For the financial statements and related notes to each fiscal year's financial audit report, refer to FCA's Performance and Accountability Report (PAR) for that year. The PARs can be found at www.fca.gov/reports/performance_reports.html.

Farm Credit Administration

Office of Inspector General
1501 Farm Credit Drive
McLean, Virginia 22102-5090
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November 7, 2007

The Honorable Nancy C. Pellett
Chairman of the Board
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Chairman Pellett:

This letter transmits the report on the audit of the Farm Credit Administration's (FCA's or Agency's) financial statements, internal control over financial reporting, and compliance with certain laws and regulations for the fiscal year ended September 30, 2007. The Office of Inspector General (OIG) contracted with the U.S. Department of the Treasury's Bureau of the Public Debt (BPD) to hire the independent accounting firm Brown & Company CPAs, PLLC, (Brown & Co.) to perform the audit.

Brown & Co. issued an unqualified opinion on the Agency's financial statements. It opined that FCA's principal financial statements present fairly, in all material respects, the financial position of the Agency as of September 30, 2007 and 2006, in conformity with generally accepted accounting principles. Brown & Co. issued two other reports. Its report on internal control noted no material weaknesses. Brown & Co.'s report on compliance with laws and regulations relating to the Agency's determination of financial statement amounts does not note any instances of noncompliance. In OIG's opinion, Brown & Co.'s work provides a reasonable basis on which to render its opinion, and we concur with its reports.

OIG's contract with BPD required that Brown & Co. perform the audit in accordance with "Government Auditing Standards" issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements." To ensure the quality of the work performed, OIG

- reviewed Brown & Co.'s approach to, and planning of, the audit;
- evaluated the qualifications and independence of the auditors;
- monitored the progress of the audit;
- examined work papers; and
- reviewed the audit reports.

As part of the Agency's annual Performance and Accountability Report, the Inspector General is required by law to provide a summary statement on the most serious management and performance challenges facing the Agency. These challenges fall into two general categories. First are the challenges related to FCA's mission of ensuring a safe, sound, and dependable Farm Credit System (FCS or System) as a source of credit and related services to agriculture. Some of these challenges may be influenced by events outside the control of the Agency. Second, but no less important, are the challenges related to Agency operations.

Management and Performance Challenges

Farm Credit System

The System is a lender to a single industry, agriculture, and is therefore vulnerable to economic swings in that industry. Nevertheless, the FCS remains sound in all material respects. Earnings and capital levels have continued to strengthen, and asset quality remains high. The Agency's challenge is to continue to ensure the System's ability to withstand this vulnerability through effective examination and regulatory activities. The Agency's regulatory attention must also address other vulnerabilities in the System. Among these are scope of lending excesses and risks associated with exposure to new enterprises, such as alternative fuel production.

There continue to be many issues facing agriculture and rural America today that raise the question of whether there should be modifications to the Farm Credit Act of 1971, as amended, (Act) to enable the System to better serve agricultural and rural economies of the future. On the basis of FCS studies of agriculture's future financial needs and the System's ability to meet those needs, the FCS proposed to Congress in early 2007 legislative changes to the Act. FCA also met with Congress to discuss potential amendments to the Act.

Farm Credit Administration

Despite whether there are modifications to the Act, the Agency should anticipate that the System will seek broad regulatory interpretations. However, as a financial regulator, FCA must continue to maintain an independent and objective, yet flexible and responsive, regulatory environment for the System, geared to continually ensuring the FCS fulfills its public policy purpose. Key to this for FCA is effective examination and regulation of System institutions by maintaining a properly staffed and resourced Agency.

Agency Governance—The Act provides for a full-time, three-member FCA Board to govern the Agency. FCA Board members are appointed by the President and confirmed by the Senate. The FCA Board's rules of operation are a foundation for trust and shared expectations among its members. They are intended to enable the FCA Board to engage in professional policy debate and to set a sound course for the Agency.

However, a small, full-time FCA Board presents a challenge in defining the roles and responsibilities of its members. Periodic changes in the chairmanship and composition of the FCA Board also present both challenges and opportunities. The Chairman has addressed these challenges and taken advantage of these opportunities by creating an environment that promotes a constructive working relationship among FCA Board members.

Strategic Planning—In December 2003, the FCA Board adopted the Strategic Plan for Fiscal Years 2004–2009. Since the adoption of this plan, the FCA Board has acquired a new Chairman and two new members. These changes in leadership have provided an opportunity to revise the plan to ensure it incorporates the current FCA Board's vision. In 2005, the FCA Board established a Strategic Planning Committee (SPC) composed of Agency staff to facilitate FCA Board input into the plan and the planning process.

While the SPC has initiated strategic planning discussions between the FCA Board and management, this has not culminated in a revised strategic plan. The Agency is required to revise its strategic plan at least every three years. The FCA Board should adopt an updated strategic plan.

Human Capital—In March 2001, OIG recommended that FCA develop a human capital plan, and FCA management agreed. Chairman Pellett assumed the chairmanship in May 2004. In 2006, a five-year strategic human capital plan was completed.

FCA's challenge is to continue to implement the human capital plan to ensure that FCA has the staff it needs to effectively regulate a constantly evolving FCS. In meeting this challenge, the Agency should continue to address the attrition of seasoned staff by

- recruiting new employees;
- training staff;
- implementing succession planning; and
- capturing, preserving, and transferring knowledge from departing employees.

To ensure the viability of the examination staff, a critical component of the Agency's regulatory capability, the Agency should

- carefully recruit and train examiners,
- maintain a rigorous commissioning program, and
- organize examiners to promote effective work processes and efficient use of the examiner workforce.

These measures should ensure that FCA examiners have the skills they need to do their jobs and maintain ongoing credibility with System institutions, and that there is continuity in the examination workforce.

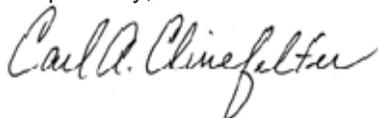
Financial Management—Timely, accurate, and useful financial information is essential for

- making day-to-day decisions,
- managing the Agency's operations more effectively,
- supporting results-oriented management approaches, and
- ensuring accountability.

In April 2006, FCA outsourced the accounting, financial reporting, and procurement functions to the BPD. Subsequent to that outsourcing, management determined it was not getting timely and efficient service in procurement and therefore brought the procurement function back into the Agency. To ensure the ongoing effectiveness of the outsourcing of the other functions, the Agency will need to continually assess both cost-effectiveness and BPD's performance in providing timely service, useful financial reporting, and improved efficiencies to the Agency.

Leveraging Technology—Information technology (IT) is a key element in management's efforts to continually improve Agency performance. The Agency is in the early stages of a major infrastructure transition designed to promote efficient work processes and to provide staff with enhanced communication and collaboration tools. The challenge is to stay abreast of emerging technologies and to establish an IT infrastructure that provides FCA staff with IT tools and skills to operate in an efficient, effective, and secure manner. In addition, the Agency must ensure that its technical staff has the skills and knowledge to implement and maintain its infrastructure, and initiatives in this regard are underway.

Respectfully,



Carl A. Clinefelter
Inspector General



INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

Farm Credit Administration
The Board and Office of Inspector General

We have audited the accompanying balance sheet of the Farm Credit Administration as of September 30, 2007, and the related statements of net cost, changes in net position, and budgetary resources for the year then ended. The balance sheet as of September 30, 2006, and the related statements of net cost, changes in net position and financing, and the combined statement of budgetary resources for the year then ended were audited by other auditors, whose report dated November 3, 2006, expressed an unqualified opinion on those statements. These financial statements are the responsibility of the Farm Credit Administration's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Farm Credit Administration as of September 30, 2007 and 2006, and its net costs, changes in net position, and budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with U.S. Government Auditing Standards and OMB Bulletin No. 07-04, we have also issued a report dated November 5, 2007 on our consideration of the Farm Credit Administration's internal control over financial reporting and its compliance with provisions of laws and regulations. Those reports are an integral part of an audit performed in accordance with U.S. Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The information in "Management's Discussion & Analysis" is presented for the purpose of additional analysis and is required by OMB Circular No. A-136, revised *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and, accordingly, express no opinion on it.

Largo, Maryland
November 5, 2007



INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

Farm Credit Administration
The Board and Office of Inspector General

We have audited the financial statements of the Farm Credit Administration as of and for the year ended September 30, 2007, and have issued our report thereon dated November 5, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; and the standards applicable to financial audits contained in U.S Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the Farm Credit Administration's internal control over financial reporting by obtaining an understanding of the Farm Credit Administration's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide an opinion on internal control and therefore, we do not express an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be significant deficiencies. Under standards issued by the American Institute of Certified Public Accountants and OMB Bulletin No. 07-04, a significant deficiency is a deficiency in internal control, or a combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a material weakness. A material weakness is a significant deficiency, or combination of significant deficiencies, that result in a more than remote likelihood that a material misstatement of the financial statements will not be prevented or detected. Because of inherent limitations in internal controls, misstatements, losses, or non-compliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be significant deficiencies or material weaknesses as defined above.

In addition, with respect to internal control objective related to the performance measures included in the "Management's Discussion & Analysis," we obtained an understanding of the design of internal controls relating to the existence and completeness assertions, and determined whether they have been placed in operation as required by OMB Bulletin No. 07-04. Our procedures were not designed to provide opinion on internal control over reported performance measures, and, accordingly, we do not express an opinion on such controls.



This report is intended solely for the information and use of the management of the Farm Credit Administration, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Largo, Maryland
November 5, 2007



**INDEPENDENT AUDITOR'S REPORT ON
COMPLIANCE WITH LAWS AND REGULATIONS**

Farm Credit Administration
The Board and Office of Inspector General

We have audited the financial statements of the Farm Credit Administration as of and for the year ended September 30, 2007, and have issued our report thereon dated November 5, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.

The management of the Farm Credit Administration is responsible for complying with laws and regulations applicable to the Farm Credit Administration. As part of obtaining reasonable assurance about whether the Farm Credit Administration's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 07-04. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the Farm Credit Administration.

The results of our tests of compliance disclosed no reportable instances of noncompliance with other laws and regulations discussed in the preceding paragraph that are required to be reported under U.S. Government Auditing Standards or OMB Bulletin No. 07-04.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion. However, we noted no noncompliance with laws and regulations, which could have a direct and material effect on the determination of financial statement amounts.

This report is intended solely for the information and use of the management of the Farm Credit Administration, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties

Largo, Maryland
November 5, 2007

R E P O R T

Fraud | Waste | Abuse | Mismanagement



FARM CREDIT ADMINISTRATION
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